



State of Delaware

Court Modernization Review Committee Meeting Minutes

This meeting was held on October 29, 2019, in conference room 219 of the Haslet Armory located at 122 Martin Luther King Jr. Blvd S, Dover, DE 19901.

Committee Members Represented or in Attendance:

Director Mike Jackson	Office of Management and Budget
Senator David Sokola	Co-chair, Joint Legislative Committee on the Capital Improvement Program
Senator Brian Pettyjohn	Delaware State Senate, minority party appointee
Representative Ron Gray	Delaware House of Representatives, minority party appointee
Mike Morton	Controller General
Chief Judge Michael Newell	Delaware Family Court
Secretary Rick Geisenberger	Department of Finance
Rob Rider	Delaware Prosperity Partnership
Tom McGonigle	Delaware Bar Association

Committee Members Not Represented or in Attendance:

Chief Justice Leo Strine	Delaware Supreme Court
Senator Quinton Johnson	Co-chair, Joint Finance Committee
Senator Harris McDowell	Co-chair, Joint Finance Committee
Representative Debra Heffernan	Co-chair, Joint Legislative Committee on the Capital Improvement Program

Others in Attendance:

Bill Lenihan	Nicole Alvarez	Geoff Stewart	Robert Scoglietti
Andy Lubin	Ellie Torres	Marcel Ham	
Michael Svaby	Saul Hernandez	Laird Stabler	
Nicole Polite	Evelyn Nestlerode	Jason Smith	
Stephanie Scola	Kyle Baranski	Mary Francoeur	

I. Call to order

Director Mike Jackson called to order the Court Modernization Review Committee at 10:00 A.M. on October 29, 2019.

II. Introductions

Director Jackson asked the attendees to introduce themselves.

III. Approval of Minutes

A motion was made by Senator Pettyjohn and seconded by Mike Morton to approve the minutes from the meeting on October 10, 2019 and the minutes were approved.

IV. Public-Private Partnership Financial Modeling

Eric Petersen from Hawkins Delafield & Wood provided a summary of a Public-Private Partnership (P3). A P3 is also referred to as design-build-finance-operate maintain ("DBFOM") merges design, construction, private financing, and long-term operations and maintenance under a single integrated contract. This is in contrast to the traditional design-bid-build ("DBB") delivery method, in which the State will enter into a contract with an architect for 100% of the design, another contract with the lowest responsible builder for the construction, and multiple short-term operation and maintenance contracts over the course of the asset's life. Mr. Petersen noted that a P3 is a risk sharing, lifecycle procurement approach that guarantees performance and is not privatization, or a funding solution, so it is not right for every project.

P3 courthouse projects have been successfully procured and completed North America and worldwide. The examples provided were Long Beach, California (constructed/operational); Brooklyn Supreme Criminal and Family court (constructed/operational); Waterloo, Ontario (constructed/operational); Durham Ontario (constructed/operational); Howard County, MD (in construction); Travis County, TX (in construction); Miami Dade County (preferred bidder).

Because the P3 delivery is based on 100% private financing, the State would not start paying for the courthouses until they are completed and ready for occupancy by the State. A publicly financed single lump sum payment, payable after the courthouses are completed, may also be worth consideration by the State. Such a "hybrid P3", based on partial private and partial public financing, combines the lower cost of public financing (due to tax exemption and project-risk-free nature of public financing) with the risk transfer of private financing. This hybrid P3 model was also used by Howard County, Maryland for its Courthouse P3 that successfully reached financial close last October.

P3 financials also require life cycle cost assumptions, savings and financing assumptions reflecting the risk transfer to the P3 developer.

Marcel Ham from Hawkins Delafield and Wood presented potential financial scenarios examining the costs of the State entering into a P3 arrangement for courthouse construction and maintenance.

- Total project CAPEX costs are projected to be \$83.0 million for Sussex, \$80.5 million for Kent and \$54.7 million for New Castle.
- P3 for two courthouses with and \$80 million milestone payment leads to an annual expense of \$13 to \$14 million for the first 20 years after substantial completion.

- P3 for two courthouses without a milestone payment leads to an annual expense of \$13 to \$15 million after substantial completion.
- P3 for three courthouses with a \$105 million milestone payment leads to an annual expense of approximately \$18 million for the first 20 years after substantial completion.
- P3 for three courthouses without a milestone payment leads to an annual expense of \$18 to \$20 million after substantial completion.

The bundling of all three projects is expected to generate efficiencies, especially with regard to transaction costs. Bundling will also provide economies of scale resulting in strong market interest and increased competition. A bundling of just the two-Family Courthouse projects may also be large enough in capital size to succeed as a P3, but may result in fewer efficiencies, particularly given the additional transaction costs associated with P3 procurements, then if all three courthouses were procured together. The completion of all three courthouse projects through traditional contracting and financing methods is likely to take several decades and does not result in any of the advantages identified above.

Is there a different risk profile for the NCC Customs House?

- Though the NCC Customs House is very different, it is still better to bundle, and it will still create efficiencies on all three. Customs house is still virtually a new build and though you could possibly do two (Sussex and Kent) for \$150 million, three buildings would be most attractive to a P3 bidder.

What if we pay it through our General Fund (cash) – how does that change it?

- There would be progress payments around \$80 million dollars during construction. The percentage of the milestone can also change higher/lower.

Could we do this as an a-la-cart project originally such as having options in the bidding process to only build one vs. setting it up to only have all three at the beginning?

- It is recommended that you have the scope of the project firm when you go to bid, because the market wants to know that you are serious to get the best interest in the project.

Is the construction cost \$400 million?

- Yes, that is comparable to other similar projects.
- Courthouses are some of the most expensive projects to build because you have three levels of circulation for the secure judicial, public and detainee areas so there is redundancy for security and risk aversion.

V. Financial Impact of a P3 to the State

Public Financial Management (PFM) is the State's financial advisor and provided an overview of how the outside world will view both a P3 and what the risks are for the state. Geoff Stewart, PFM, explained that the rating agencies utilize an objective scoring to rate states. Delaware is a Aaa state, but our score would indicate that we are at the lower range of a Aaa rating. There is not a fully clear-cut explanation of how a state goes up and down on the scoring, but we can recognize areas that would clearly tip the scale in one direction or another.

How will a P3 with an availability payment structure be treated in our financial statements/ Comprehensive Annual Financial Report (CAFR)?

Any Operating and Maintenance (O&M) agreement, whether within or outside of the capital agreement, will need to be recorded as liability. If it is cancelable, you must assess the likelihood of canceling and not putting any other agreement in place. A transferable agreement would need to be recorded. The liability is recorded as the present value of expected future payments, expensed annually.

How will a P3 with an availability payment structure be viewed by the rating agencies?

Depending on the agreement, rating agencies view these obligations as debt-like and include them in their analysis of a state or local government's total debt burden. This applies to cases where there are contractual obligations and material liability to the government. The treatment of contractual availability payments is similar to the treatment of other contractual obligations and leases for state governments, particularly abatement leases where payments are not made if a project is unavailable. This debt-like treatment would not apply to demand-risk P3s where the government does not provide contractual payments or assume contingent liability if the project fails. In an availability-payment P3, the state would commit to a stream of payments that, on a case by case basis, may be considered debt-like and included in their measures of government debt. The availability payment P3 contract obligations would be considered debt to the rating agency if the state commits to make scheduled payments, with limited "outs" and agrees to make termination payments to limit the degree of risk transfer to the private sector. The state may not report a liability during construction since accounting guidance in the US does not specify the treatment of availability-payment P3 liabilities. If the project-specific documents are not available, rating agencies will use an assumed termination payment of 80% of the debt outstanding. This amount will be pro-rated in proportion to estimated construction progress.

The rating agencies do include this liability in the government's direct debt.

How will a P3 with an availability payment structure be treated in Delaware Debt Tests (5% & 15%)?

The Debt Tests were adopted in 1991.

A. The 5% Test

Aggregate principal amount of new “tax-supported obligations of the State” which may be authorized in any one fiscal year may not exceed 5% of estimated net budgetary General Fund revenue for that fiscal year, as determined by a Joint Resolution approved by a majority of the members elected to each house of the General Assembly and signed by the Governor in conjunction with adoption of the annual Budget Appropriation Bill for that fiscal year.

Tax-supported obligations of the State include (i) all obligations of the State or any agency or authority thereof to which the State’s full faith and credit is pledged, and (ii) all Obligations of the State or any agency or authority extending beyond one year with respect to the lease, occupancy or acquisition of property which are incurred in connection with debt financing transactions and which are payable from taxes, fees, permits, licenses, fines imposed or approved by the General Assembly.

If there is a \$4 billion General Fund budget, the authorization for new debt issuance is roughly \$200 million of general obligation bonds.

Will the Courthouse projects financed with an availability payment structure be considered tax-supported obligations of the State included in the 5% Test?

- Rating agencies view this as net tax supported debt and that once the project is delivered, it will be on the balance sheet. We can work with the bond agencies, but the concern is will they see it as having gone around the 5% test.
- The 15% Test is one of the pillars of the Debt Tests and is a guide to our debt burden and annual debt service requirements to taxpayers. We don’t want to be spending more than 15% of our revenues on debt service. This includes general obligation bonds and Transportation Trust Fund (TTF) debt service.
- The Debt Tests (5% & 15%) are statutory, not in the constitution, so they could be changed with a majority vote to change the requirements or language. However, that won’t change how the rating agencies view it.

Potential Rating Impact

- PFM analyzed the impact of the additional courthouse burden on the State’s credit rating metrics in Moody’s rating scorecard.
- Debt category is weighted 25% and includes both net tax supported debt and adjusted net pension liability.
- Additional courthouse debt results in a modest increase to the debt and finance scores and overall score.
- The State’s overall score of 3.54 currently is Aa1 rating.
 - o The final rating assigned is Aaa thanks to a subjective one notch upward adjustment.
- A deviation from the State’s statutory debt limits will get the attention of the rating agencies.
- We carry a lot of burden of debt at the State level.

Long-Term Liability Pressures

- Delaware's comparatively high spending on long-term liabilities as a percentage of operating expenditures, currently 11th in the country, is driven largely by Other Post Employment Benefits (OPEB) pay-go costs, given relatively moderate debt service and pension contributions.
- The current OPEB data is dated and will most likely increase when new numbers are released.

Could this project tip the rating scoring and cause our rating to go down?

- Potentially yes. This would represent a 10% increase in the rating agency scoring, but it does round us to the next level, though it's not assured that it will make our rating go down.
- Exceeding the statutory 5% test would likely have an impact on the State's bond rating. Also, since a P3 would show up as an expense on the balance sheet, this would be considered debt and would therefore likely impact the bond rating.

The next meeting will focus on what we agree to on the findings from the information provided at the prior meetings to be able to submit a report.

Next meeting was tentatively scheduled for November 13, but due to scheduling conflicts, OMB will work to find a new date.

VI. Public Comment

There was no public comment.

VII. Adjournment

A motion to adjourn was made by Secretary Geisenberger and seconded by Mike Morton at 12:09 P.M.

Respectfully Submitted,

Ronda Ramsburg